The Market in Review

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This week's articles and insights

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"Up and down, up and down, I will lead them up and down … the course of true love never did run smooth."

— William Shakespeare, A Midsummer Night's Dream

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	27,387	+ 4.08%	- 4.03%
S&P 500	3,349	+ 3.17%	+3.66%
TSX	16,579	+ 1.71%	- 2.84%

Midsummer Night's Theme

It is now Midsummer, which puts us smack in the middle of the market year. August is normally a flat month for markets, yet can be strong in election years.

For many years, the refrain of "Sell in May and go away" was a very profitable course of action. Investors who held on from November 1st through April 30th outpaced those who stayed in the market during the May 1st through October 31st period by a factor of several multiples. The Stock Trader's Almanac formalized this adage into concrete research and named it the "*Best Six Months*" Strategy.

The pattern has been investigated going back to the turn of the century, but the cycle predates the 20th century. Ever since humans learned how to farm, the seasonal production of food has shaped our lives.

Wars are a prime example of human activity shaped by the crop cycle. March is named after Mars, the Roman god of war, partly because the campaign season began in March. The Tubilustrium was a ceremony held on March 23rd (the spring solstice) to prepare the army for war. Battles were fought after the crops were sown, both so that there would be food when they returned and to let the winter roads dry out for the movement of troops.

In more modern times - and once banking evolved - farmers spent heavily on seed and fertilizer in the spring. This meant money was withdrawn from country banks. The banks would sell investments during the spring to raise this cash, which may have included stocks. Conversely, when the crops were harvested in the fall and sold to the grain pools, money flowed back into farmer's pockets and then to their banks. The funds would then be reinvested for the winter.

Therefore, the "seasonal best months" to invest – November through April - were those experiencing money flows <u>in</u>. When farmers were flush with cash. The "seasonal worst months" were those experiencing money flows <u>out</u>.

The economy has evolved, of course. Only about 2% of North America's citizens today are involved in the agricultural sector, which suggests this seasonal pattern should no longer hold up. However, the "Sell in May" pattern continues to do well. Are there reasons that this pattern still works? Have new patterns emerged that have replaced the old agricultural ones?

Taxes are a bigger factor today. In the US, income taxes are due on April 15th and Canadian ones on April 30th. This is another reason money is pulled from the stock market in the spring. Another reason is the school and vacation cycle. Some European nations virtually shut down in August for holidays. Vacations are expensive - another reason for money to be withdrawn from investments over the summer.

A third possibility is the election cycle. The US federal election normally occurs in early November of each fourth year. Money collectively holds its breath until a new president is decided upon, after which stocks often rally.

So, there are still logical reasons for the “Sell in May” cycle to continue.

However, recent market crashes have thrown a wrench into the works. While a good part of the 2008 decline occurred in October, even more losses occurred from November through March of 2009.

And 2019 through 2020? The “best months” period this year was awful - some of the worst losses in decades. The summer months are normally flat, followed by weakness in the fall. That has not been the case this year.

Yet, even with the two big declines of 2008-9 and 2020 included, the pattern of November-through-April beating May-through-October continues as an enduring regularity.

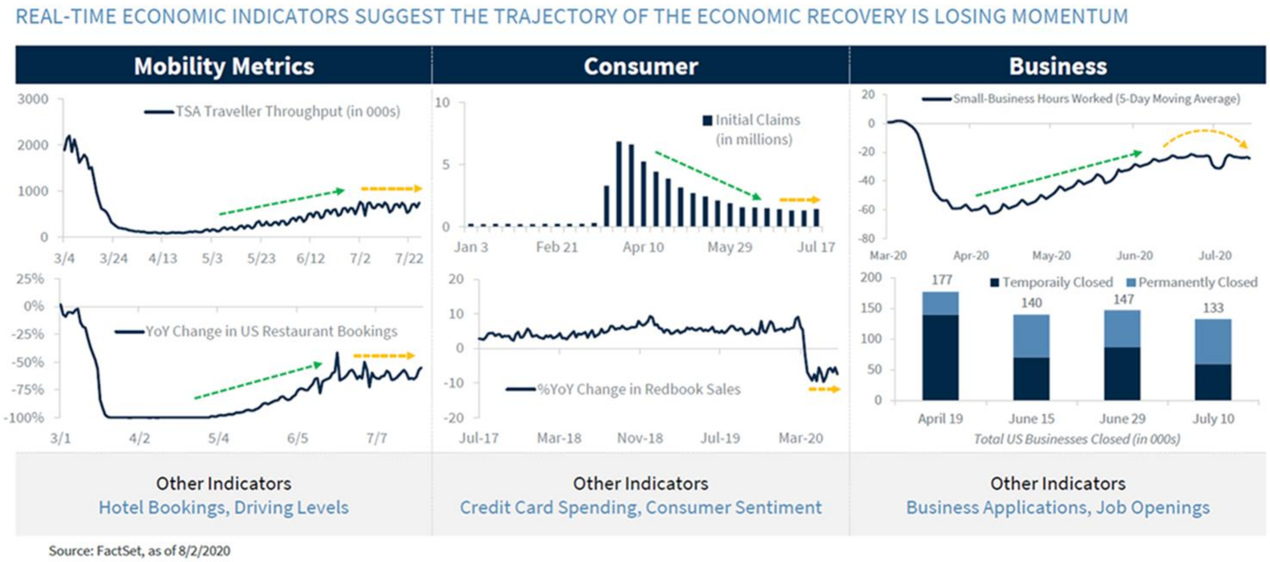
Just not this year. At least, so far. We still have a tense U.S. election ahead and souring relations with China. It could be an interesting autumn.

Markets This Week

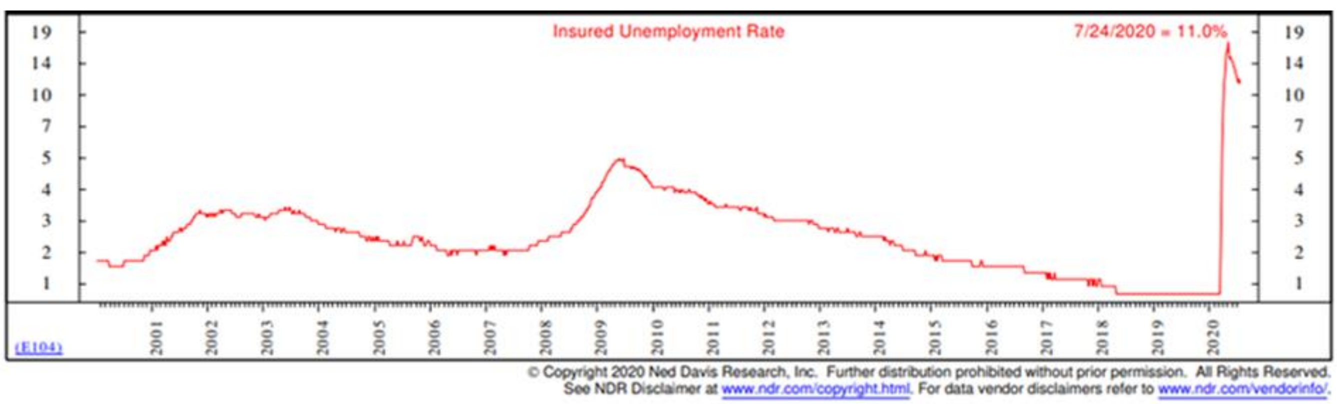
Another interesting week.

Many clients have asked why markets can continue to rise even as the economy is in poor shape. As we have mentioned in previous letters, market conditions don’t have to be “good” for stocks to rise, they just have to be “better”.

As shown below, airline travel, restaurant bookings, and business hours worked improved up until July, then flat-lined:

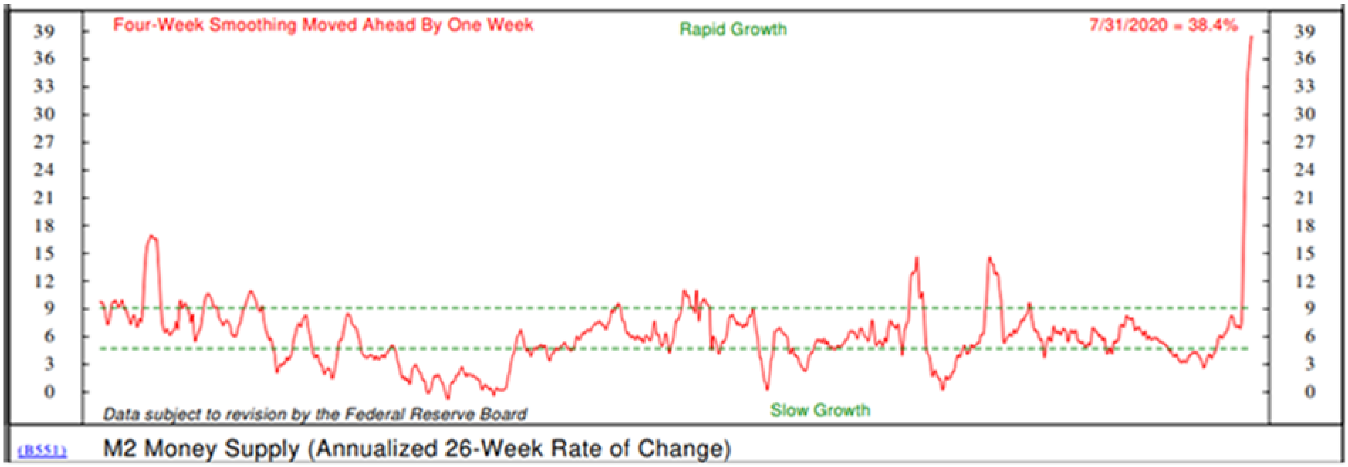


U.S. unemployment is also improving. As long as you compare the current 11% unemployment to the 19% rate in April:



Because of rising virus infections in several states and renewed lockdowns, it is understood that support measures in both Canada and the U.S. will have to be extended. U.S. Democrats want another $3T in stimulus measures while the Republicans are offering $1T. There will be lots of fighting, but they will converge in the middle around $2T.

July's weakness means more stimulus is on the way. M2 is a measure of money supply:



As mentioned at the beginning of this letter, stocks do best when money is flowing in. There is an old saying that goes:

"In the land of the blind, the one-eyed man is king."

We can rephrase that as follows:

"In the land of zeroes, stocks are heroes."

In today's world of 0% interest rates, stocks look better than most alternatives. All that money has to go somewhere, and stocks are "prime real estate" for money.

It should also be mentioned how crazy the world is going for gold right now. The world's largest physical bullion ETF – the SPDR Gold Shares (**NYSE GLD**) – now holds 1,258 tons of gold bullion. This is more than a quarter of all the gold held at Fort Knox, and exceeds the gold reserves of the Bank of Japan, the Bank of England or the Reserve Bank of India.

Two Points to Ponder

First, we have soaring inflation and deepening deflation happening together, which is a very strange occurrence.

CNN reports:

"From February to June, meat and poultry prices rose nearly 11%, with beef and veal prices seeing the highest rise, spiking 20%. For pork the increase was about 8.5%. People are paying more for other staples, too: During the same time period, egg prices shot up 10%, and shoppers shelled out 4% more for cereals and fresh vegetables."

At the same time, we are seeing deflation in what <u>isn't</u> being consumed nearly as much, such as gasoline, hotel rooms, and airplane tickets.

This makes the inflation average appear tame, even as its components are distorting our pocketbooks.

It should also be mentioned that people get very angry when food prices rise. The Arab Spring movement began with food shortages in Syria years ago. This summer's riots may be a version of our own Arab Spring.

Part of the price increase was due to increases in shipment costs during March and April when millions were sheltering in their homes. These pressures are now lessening.

Second, another point to ponder is the pace of a vaccine – or multiple vaccines – for the coronavirus. There are three phases to a drug or vaccine's development:

Phase 1: Is it safe?
Phase 2: Does it work?
Phase 3: How much of a dose is needed and are there side-effects?

Several vaccine candidates have successfully passed Phase 2. Thanks to the huge push and relaxation of many rules, we are likely to see Phase 3 data for at least one of the new vaccines in early November. This means inoculations could begin this year.

Goldman Sachs suggests that "***Rising chances of an approved coronavirus vaccine by the end of November are underpriced by equity markets***."

While this may seem like an overly rosy scenario, it cannot be ruled out. Stocks may be rising today because they sense a sooner-than-expected solution to the pandemic.

Such a scenario would also <u>not</u> be positive for the "pandemic stocks", such as Amazon (**NASDAQ AMZN**) and Zoom Video (**NASDAQ ZM**). Yes, their business models will continue to do well, but not as well as when everyone is forced to use their services.

Animal Farm

"All animals are equal, but some animals are more equal than others."

- George Orwell, Animal Farm

While stock indexes are near all-time highs, they have been lifted by just a few huge stocks. The Big 6 technology stocks now represent over 25% of the S&P 500 and are larger than every stock exchange in the world with the exception of the US. Canada's entire stock market is less than 1/3 the size of these six tech giants combined.

The rest? Many quality stocks are still trading where they were in April. So, when you invest in any of the following Canadian blue chips, you are not paying all-time high prices. In fact,they are quite moderate, with decent yields:

Company	Yield
Telus	4.8%
TransCanada	5.2%
Fortis	3.5%
Rogers Comm.	3.6%
TD Bank	5.2%
Bank of Montreal	5.7%
Nutrien	5.1%
Suncor	3.8%

Global giants such as Nestle, Nintendo, Honda, BMW, HSBC, and Glaxo are also lost in the shadows of the Big 6 US companies. International stocks now trade at some of the widest valuation discounts to their US counterparts in years.

In fact, we may be facing a moment similar to those in 1973 and 2000. In both periods, the market had narrowed to one select group of stocks.

In 1973, the **Nifty-Fifty** was the name for a group of 50 stocks that were no-brainers. Who could lose with Xerox, Polaroid and Avon? Yet Xerox fell 71%, Avon 86% and Polaroid 91% over the next decade. The best of the others barely broke even. Why? Because they were expensive and over-popular.

Same thing in 2000 when the dot.com stocks captured the world's fancy. I remember losing a client in 1999 for not buying Cisco (**NASDAQ CSCO**) at $80 a share. Cisco peaked at $140 a year later then fell below $9 in the ensuing bear market. It has never touched $80 since.

What followed 1973 was a bear market, then a massive shift to a whole different breed of stocks: value stocks led by commodities and vicious inflation. Perhaps gold's recent rise is signaling such a shift. Oil also rose as much as gold in the 1970s and no manager could survive without a sizeable portion of oil in their holdings.

It is almost a sin to speak of energy stocks these days. The industry has been the worst of every S&P 500 sector in the US. Production has been shut worldwide, drill rigs idled, and workers laid off. Many wells will never be turned on again and valuable knowledge will never return.

Also, the US shale miracle is now in the rear view mirror. The best acreage has been drilled and the easiest oil already pulled out. "High-graded" as they call it.

If we beat this virus and people start travelling again, oil demand will rise. Perhaps not to where it was, but people have short memories. We will want to travel again to make up for lost time.

When oil demand returns, where will that oil come from? Not from offshore rigs – many of those have been scrapped and their unsightly activity banned by fossil-free governments. Not from shale, which has been tapped. Not from the oil sands, whose name is only muttered in dark places. And not from the rusting wells of the Middle East, many countries of which are under sanctions.

The surprises ahead may be inflation and all those newly-printed dollars chasing scarce commodities. Yes, it sounds unlikely, but it happened after 1973 and 2000.

Procrastinating on Pensions

Both U.S. Social Security and Canada's Canada Pension Plan (CPP) have features to encourage people to delay receiving payments. Yet very few do. More than 95% of Canadians have taken CPP payments at age 65 or earlier since the plan was revised to allow flexible retirement in the 1980s.

In Canada, you are discounted approximately 7% for every year early you take CPP. If you start your pension at 64 instead of 65, for example, you get $928 instead of $1,000. This works backward until you face a 36% discount if you start at age 60. The US system is similar.

However, if you wait until 66, you get almost ***8.5% more*** - $1,084 instead of $1,000. This means your government pension will be over 40% higher at age 70 than it would be at age 65.

This didn't matter as much when interest rates were higher. You could just stuff your early pension into a 5% term deposit and pretty much make back the difference. With rates near 0% now, though, the enhanced payment is a gift.

One study shows that 75% to 80% of Canadians would be better off financially by delaying CPP payments.

Thank you for your referrals this month! They are always handled with great care and discretion.

http://www.dividendvaluepartners.com

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